IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76- 390

ICI AMERICA INC., *Petitioner*

v.

MORAINE PRODUCTS, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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CITATIONS

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Petitioner ICI America Inc. prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above-entitled case on June 18, 1976.

OPINIONS BELOW

The United States District Court for the Northern District of Illinois entered a directed verdict from the bench in favor of petitioner on March 27, 1975. Pertinent portions of the trial transcript relating to the directed verdict and the minute order thereon are

printed in the Appendix hereto, at pp. 1a to 3a. The unreported opinion of the Court below, reversing in part the District Court's order, appears in the Appendix at pp. 4a to 35a. The opinion in a related case between the same parties in the Sixth Circuit, *Atlas Chemical Industries, Inc.* v. *Moraine Products*, reported at 509 F. 2d 1 (1974), appears in the Appendix at pp. 36a to 48a.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Whether a person whose patent has been invalidated may thereafter maintain an action to recover antitrust treble damages under Section 4 of the Clayton Act (15 U.S.C. § 15), and do so consistently with the policies expressed in *Lear* v. *Adkins*, 395 U.S. 653:

1. Where the only injury claimed to said person's "business or property by reason of anything forbidden in the antitrust laws" is the loss of anticipated royalties from the licensing of said invalid patent to potential licensees; and

2. Where the antitrust suit is brought against a licensee under the invalid patent that has borne the burden of litigating and establishing its invalidity.

STATUTE INVOLVED

Section 4 of the Clayton Act, 15 U.S.C. § 15:

> "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by himself sustained, and the cost of suit, including a reasonable attorney's fee."

STATEMENT OF THE CASE

The jurisdiction of the District Court was invoked because of antitrust questions arising under Section 4 of the Clayton Act, 15 U.S.C. § 15.

Respondent Moraine Products (hereinafter "Moraine") is the assignee-owner of the so-called Rider Patent, No. 3,422,189, issued on January 14, 1969, about ten years after the filing date of the application therefor. The Rider Patent covers a method of using an old unpatented product, which had been generally known and used for many years prior to the patent application, for various purposes in the pharmaceutical, medical and veterinary fields, to alleviate flatulency or gas in the gastrointestinal tract of humans.

On August 10, 1970, petitioner ICI America Inc. (hereinafter "ICI-Atlas"),[1] an exclusive licensee under the Rider Patent, brought suit against Moraine in the federal District Court in Detroit, Michigan, to have the Rider Patent declared invalid. The District Court declared the patent invalid on the ground that the purported Rider invention had been in public use for more than one year prior to the filing of the Rider Patent application (see 35 U.S.C. § 102(b)), 350 F.

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[1] This will facilitate reference to the opinion of the Circuit Court below, which refers to petitioner as "Atlas" (for Atlas Chemical Industries, Inc.). ICI America Inc. is the corporate successor of Atlas Chemical Industries, Inc., which in turn was the corporate successor of The Stuart Company, the original party to the Plough/ICI-Atlas agreement of 1961 referred to in the next paragraph of the text.

Supp. 353 (E.D. Mich. So. Div. 1972). On appeal, the Circuit Court of Appeals for the Sixth Circuit affirmed this ruling of the District Court, 509 F. 2d 1 (1974) (see Appendix, pp. 36a to 48a).

On September 23, 1970, six weeks after the filing of ICI-Atlas' suit challenging the validity of the Rider Patent, respondent Moraine commenced this proceeding by filing a complaint, subsequently twice amended, in the District Court for the Northern District of Illinois against ICI-Atlas and against Plough, Inc. and Plough Laboratories, Inc. (hereinafter "Plough").[2] Moraine charged, among other things, that a patent license agreement entered into between defendants Plough and ICI-Atlas on January 19, 1961, providing for the licensing of Plough's Feinstone Patent, was a *per se* violation of the Sherman Act, or, in the alternative, that the evidence established that ICI-Atlas and Plough had conspired to unreasonably restrain trade. Moraine further charged that the effect of this alleged conspiracy was to restrict the number of licensees under Plough's Feinstone Patent, and that this reduced the number of persons who would have sought licenses under Moraine's Rider Patent, which in turn diminished Moraine's royalties from that patent. Plough and ICI-Atlas denied both Moraine's charges of conspiracy and its allegations that the alleged conspiracy extended to, or had the effect of, unduly restricting the number of licensees under the Rider Patent. Plough's Feinstone Patent, originally No. 2,951,011 and now Reissue No. 25,205, was originally issued on August 30, 1960, and reissued on July 24, 1962; it had method claims covering the treatment of gastrointestinal distress through the use of a carrier coated with an organo-poly-siloxane, as well as claims on the product so used.

[2] Plough and Block Drug Co., an alleged co-conspirator in this proceeding, were offered licenses by Moraine under the Rider Patent shortly after its issuance but declined them, whereupon Moraine instituted patent infringement proceedings against them.

At the close of Moraine's evidence, the District Court, on defendants' motion, directed a verdict in favor of the defendants, ruling from the bench that the Plough/ICI-Atlas January 19, 1961 license agreement was legal, and that Moraine had failed to establish that Plough had conspired with ICI-Atlas to unreasonably restrain trade in violation of 15 U.S.C. § 1[3]. On appeal, the Circuit Court of Appeals for the Seventh Circuit affirmed the District Court's conclusion that the Plough/ICI-Atlas agreement was not a *per se* antitrust violation. But it reversed in part and ordered a new trial, holding that the jury should have been allowed to decide whether ICI had unreasonably restrained commerce under the "Rule of Reason" (see Appendix, page 26a).

The questions presented by this petition arise from the Circuit Court's rejection of petitioner's argument that the District Court's action in directing a verdict against Moraine should have been affirmed, on the grounds that Moraine's alleged loss of royalties based on an invalid patent was not a compensable injury to Moraine's business or property, within the meaning of

[3] Following entry of the directed verdict, Moraine and Plough reached a settlement agreement. Upon a stipulation entered into between Moraine and Plough, the District Court entered an order dismissing the complaint as to Plough with prejudice and Plough is no longer a party hereto.

Section 4 of the Clayton Act (15 U.S.C. § 15),[4] and that to allow Moraine to continue prosecuting an antitrust action based on an invalid patent contravened the policies laid down by this Court in *Lear* v. *Adkins*, 395 U.S. 653 (1969). The Circuit Court's opinion recognized that Moraine's claim for alleged royalties under an invalid patent was a "troublesome aspect of the continuance of this litigation", and then indicated why (Appendix, p. 31a):—

> "Although there is some basis to an argument that the underlying policy of *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969), points to a conclusion that Moraine, the holder of a patent subsequently determined to be invalid, should not be able to recover damages predicated in effect upon licensing royalties, we are not persuaded that such policy considerations override Moraine's rights under the antitrust laws. While there are paradoxical aspects of allowing recovery to arise from illegal interference with the sale of something which ultimately was proven to have no sales value, it cannot be said that there was no such value during the period of the presumptive validity of the patent."

REASONS FOR GRANTING THE WRIT

For the purposes of this petition, it will be assumed that respondent Moraine will be able to establish certain conclusions that are currently very much in issue and which, under the Circuit Court's decision, must be submitted to the jury—that petitioner ICI-Atlas agreed with Plough to limit the number of licensees that would be licensed under the Feinstone patent;

[4] The Circuit Court dismissed this ground summarily, despite the fact that it had been argued and briefed to that Court, see pp. 40 to 46 of Brief of Defendant-Appellee Atlas (ICI America, Inc.), served August 25, 1975.

that this agreement unreasonably restrained trade; that there were firms that would have taken licenses under Moraine's Rider Patent, despite the fact that its validity was so early in dispute (see pp. 3, 4 fn. 3, *supra*); and that the Plough/ICI-Atlas agreement, executed in 1961, had the effect of restricting the number of licensees under Moraine's Rider Patent, issued in 1969. Even were all of these conclusions established, Moraine's antitrust case must fail, because of a fatal defect:—Moraine has failed to establish, as required by Section 4 of the Clayton Act (15 U.S.C. § 15), that it was injured in its business or property. The showing of such injury is an essential element in establishing liability in a private treble damage action, *Hawaii* v. *Standard Oil Co.*, 405 U.S. 251 (1972); *Kline* v. *Coldwell, Banker & Co.*, 508 F. 2d 226 (9 Cir. 1974), *cert. denied*, 421 U.S. 963 (1975); *Shumate & Co., Inc.* v. *NASD*, 509 F. 2d 147 (5 Cir. 1975).

Respondent Moraine's sole claim to damages is based on its alleged deprivation of anticipated royalties arising from the assumed licensing of the invalidated Rider Patent. In rejecting petitioner's view that no injury or damages are sustained by a party deprived of the opportunity of licensing an invalid patent, the Circuit Court appears to rely on the theory that the Rider Patent was presumptively valid from the time of its granting until it was judicially declared invalid,[5]

[5] The only presumption of patent validity which the patent law recognizes is the statutory presumption of validity under 35 U.S.C. § 282, which relates only to judicial proceedings involving patent validity and serves only to place the burden of proof on the person asserting invalidity. The statutory presumption carries with it no implications as to the judicial effect to be given a patent after it has been adjudicated invalid, which is the issue to which the Court below directed its attention and which, in petitioner's opinion, it decided wrongly.

that it had some value during that period, and that Moraine could therefore legally entertain the expectation of receiving anticipated royalties from the licensing of the patent. Petitioner's view on the other hand is that, once the Rider Patent was judicially declared invalid, it was unenforceable and valueless for any purpose. Since Moraine's antitrust claim was based solely on its alleged loss of royalties under the invalidated and valueless Rider Patent, Moraine has not suffered any injury in its business or property and its antitrust action against ICI-Atlas must therefore fail. Petitioner will discuss this question first, and then point out why the continuation of this action would contravene the policies laid down by this Court in *Lear* v. *Adkins, supra,* page 6.

I. Moraine Has Suffered No Compensable Injury, Under Section 4 of the Clayton Act, from the Alleged Loss of Royalties Based on Its Invalid Patent.

At the outset, it should be noted that under this Court's decision in *Blonder-Tongue* v. *University of Illinois Foundation,* 402 U.S. 313 (1971), once a patent has been invalidated after full and fair adjudication, patent law recognizes no right in the holder of the invalidated patent to initiate or maintain suits against alleged infringers to recover royalties for the period prior to the judicial invalidation of the patent.

In *Blonder-Tongue,* this Court laid down the general principle that:—

> "A patent yielding returns for a device that fails to meet the congressionally imposed criteria of patentability is anomalous" (402 U.S. at 343).

That principle would be violated if the precedent set by the Court below were allowed to stand. Moraine's

antitrust complaint is an indirect method of enforcing the invalidated Rider Patent, by endeavoring to collect from ICI-Atlas, through the guise of an antitrust suit, royalties based on that valueless and discredited patent. There is no legal or logical basis for breathing life into a worthless patent, clearly unenforceable against the world, because of an antitrust claim based on the patent. "This plaintiff's patent, void as to others, is not valid as to the defendants because they may be guilty of the violation of antitrust laws," see *Bulldog Electric Products Co.* v. *Cole Electric Products Co.,* 148 F. 2d 792, 795 (2 Cir. 1945). Since Moraine's antitrust rights are based on its patent rights, it would indeed be anomalous to hold that its antitrust rights have some value, when it is clear that its patent rights have none. The basic assumption of the Court below, that the Rider Patent had some value prior to its invalidation which survived its invalidation is erroneous, since it flies in the face of *Blonder-Tongue:*—

> "the holder of a patent should not be insulated from the assertion of defenses and thus allowed to exact royalties for the use of an idea that is not in fact patentable or that is beyond the scope of the patent monopoly granted . . ." (402 U.S. at 349-50).

In support of petitioner's view that Moraine suffered no injury in its business because of the loss of anticipated royalties from its invalidated and valueless Rider Patent, may be cited two decisions from the Second and Third Circuits where, as in the present proceeding, a claim of patent invalidity triggered off a countering claim by the patentee of antitrust violation. In *SCM Corporation* v. *Radio Corporation of*

America, 407 F.2d 166 (2 Cir. 1969), *cert. denied*, 395 U.S. 943 (1969), *rehearing denied*, 396 U.S. 869 (1969), SCM sought a declaratory judgment that RCA's patents were invalid and not infringed. The Second Circuit, in discussing RCA's antitrust counterclaims, based as in this case on lost royalties, made no mention of any "presumptive validity" of the patents entitling the patentee to compensation, but said, categorically, that:—

> "At the heart of all the claims and counterclaims is the question of patent validity. If the patents are invalid the claims based thereon must fail. . . ." (p. 168).

Jones Knitting Corp. v. *Morgan*, 244 F. Supp. 235 (E.D. Pa. 1965), *rev'd on other grounds*, 361 F.2d 451 (3 Cir. 1966), involved a situation where the patentee, whose patent had been declared invalid in a declaratory judgment action, not only counterclaimed but succeeded in establishing that a group of manufacturers had engaged in a boycott against the patentee by agreeing not to negotiate with him for a license prior to obtaining a declaratory judgment as to the validity of the patent. The Court held the boycott *per se* illegal under the antitrust laws, but nevertheless ruled that the patentee was not damaged by the illegal agreement, adding further that to allow damages would unjustly enrich the patentee:—

> "If, absent the group boycott, it is reasonable to assume some one of the twelve [manufacturers] would have taken a license and thus paid royalties to Morgan [the patentee], Morgan would have been unjustly enriched since he did not have a valid patent from which a valid license could stem" (p. 239).

The principle laid down in the foregoing cases is supported by a decision in the Fifth Circuit involving an invalid contract. In *Martin* v. *Phillips Petroleum Corp.*, 365 F.2d 629 (5 Cir. 1966), *cert. denied*, 385 U.S. 991 (1966), *rehearing denied*, 386 U.S. 930 (1967), the Court held that, in an antitrust treble damage action, the plaintiff must allege and prove that he has been injured in his business or property by acts of the defendant proscribed by Section 4 of the Clayton Act; that whether the plaintiff has "property" within the meaning of Section 4 depends on whether he possesses an interest that is "deserving of legal protection"; and that an invalid contract does not constitute property subject to the protection of Section 4 of the Clayton Act (pp. 632-634).

Where, as here, a patent has been declared invalid, the legal status accorded genuine inventions by the patent laws is destroyed and all that is left is an idea which is "a part of the public domain." This Court has determined that such an idea is not an interest deserving of legal protection, because of "the important public interest in permitting full and free competition in the use of [such] ideas," *Lear* v. *Adkins*, 395 U.S. 653, 670 (1969), and the harm to the "rights and welfare of the community" if "the heavy hand of tribute be laid on each slight technological advance in an art," *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U.S. 225, 230 (1964).

The principle that the establishment of patent invalidity bars any subsequent recovery by the holder of the invalidated patent was applied by the Ninth Circuit in a case involving the tort of inducing breach of contract relating to the patent, *Massillon-Cleveland-*

Akron Sign Co. v. *Golden State Advertising Co.*, 444 F.2d 425 (9 Cir. 1971), *cert. denied*, 404 U.S. 873 (1971), *rehearing denied*, 404 U.S. 961 (1971), where the Court said:—

> "But we are of the opinion that a valid patent is a prerequisite to recovery for inducing the breach of a contract not to infringe, as well as a prerequisite to recovery for the breach itself" (p. 428).

In like vein, paralleling the decision in the *Martin* case, *supra*, p. 11, several Circuit Courts of Appeal have held that the right to recover for tortious interference with contracts presupposes the existence of a valid enforceable contract, *Bailey* v. *Banister*, 200 F.2d 683, 685 (10 Cir. 1952); *Consolidated Packaging Machinery Corp.* v. *Kelly*, 253 F.2d 49 (7 Cir. 1958), *cert. denied*, 357 U.S. 906 (1958); *Advance Industrial Security, Inc.* v. *William J. Burns International Detective Agency*, 377 F.2d 236, 238 (5 Cir. 1967).

Thus, the erroneous theory of the Court below that the holder of an invalidated patent may thereafter recover damages based on the "presumptive value" of the patent prior to invalidation conflicts with antitrust decisions in other Circuits, as well as with decisions involving the related torts of patent infringement and interference with contracts. But in addition permitting antitrust recoveries based on invalidated patents has far-reaching undesirable consequences. Thus, it becomes an overpowering incentive to the holders of patents that have been judicially challenged to respond with antitrust causes of action, as was done in this case and in the *SCM* v. *RCA* and *Jones Knitting* cases (see pp. 9, 10, above), thereby proliferating antitrust controversies in the already clogged judicial system. Also, the theory that an invalidated patent retains "presumptive value" from the date of issuance to the date of invalidation becomes a potent inducement for patentees to delay and stretch out the proceedings challenging their patents; the longer the patent proceeding is prolonged, the longer the period for which, and the greater the amount of, potential antitrust damages that may be collected by the holder of the invalid patent. And, to the extent that the theory promotes such harrassing tactics by patentees, the costs, delays and risks of litigation strangle any incentive licensees might have to challenge patent validity, an incentive to which, as the next argument will show, this Court has attached great value. Thus, the precedent set by the ruling of the Court below, if allowed to stand, will greatly impede the efficient and economic administration both of the antitrust and of the patent laws.

II. To Allow Moraine To Maintain This Antitrust Suit Against ICI-Atlas, After ICI-Atlas Had Successfully Established the Invalidity of the Patent Basic to Any Recovery by Moraine, Would Frustrate the Policies Laid Down in Lear v. Adkins.

In *Lear* v. *Adkins*, 395 U.S. 653 (1969), this Court, recognizing the importance of testing patent validity and of the vital role in connection therewith played by licensees, who "may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery" (p. 670), overruled the doctrine that licensees were estopped from challenging the validity of the patents under which they were licensed. The Court went further, and, as an additional incentive to the licensee, ruled that Lear, the licensee, "must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove patent invalidity" (page 674).

Although the *Lear* case involved only royalties under the licensee's own agreement, the rule laid down in *Lear* should govern the present case. Petitioner ICI-Atlas challenged Moraine's Rider Patent shortly after *Lear* was decided and, after burdensome and expensive litigation, successfully established that patent's invalidity. It has thereby vindicated "the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain" (page 670) and removed an invalid patent from the competitive scene. It would utterly defeat the policy underlying *Lear* to subject ICI-Atlas to further protracted antitrust litigation directed to securing from ICI-Atlas a recovery based exclusively on the potential licensing to third parties of the patent which ICI-Atlas had performed the public service of discrediting.

For this Court to declare that licensees who have succeeded in invalidating a patent should thereafter be immune not only from contractual but also from antitrust actions based upon anticipated royalties from the invalidated patent would clarify the policy of *Lear* in a manner consistent with the general law of torts. As shown on pp. 8 to 12, *supra,* antitrust law, patent law and the common law of torts all support the proposition that neither antitrust nor tort liability will lie where the sole injury claimed is an illegal interference with the licensing of an invalid patent. The teaching of *Lear* is reinforced by that of *Blonder-Tongue*—the holder of an invalid patent is not entitled to any returns based on his unpatentable idea (see pp. 8, 9, *supra*).

From the standpoint of the overall administration of the patent and antitrust laws, the ruling of the

Circuit Court that the holder of an invalidated patent may thereafter recover antitrust damages based on the "presumptive value" of the patent prior to invalidation conflicts with the rationale of *Lear,* which recognized that a requirement for the continuing payment of royalties:—

> ". . . would give the licensor an additional economic incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning. We can perceive no reason to encourage dilatory court tactics in this way. Moreover, the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the courts" (p. 673).

The ruling of the Court below will furnish licensors with incentives not only to prolong patent validity controversies, but also to launch antitrust suits, which on the whole are even more protracted and expensive. Licensors, confronted with challenges to their patents which might cause them the loss of anticipated royalties, would be induced to hedge such loss by devising antitrust theories in the hope of recovering damages based on the "presumptive value" of the patent prior to its invalidation (cf. pp. 4, 9, and 10, *supra*).

The Court below recognized that there were "paradoxical aspects" in permitting the maintenance of an antitrust action predicated on illegal interference with the licensing of a worthless patent, see page 6, *supra.* However, it failed to recognize that such permission conflicted with *Lear.* Nor did it perceive the real nature of the paradox involved—that ICI-Atlas, which had upheld the public interest by making it impossible for Moraine to obtain windfall damages from infrin-

gers of its worthless patent or windfall royalties from possible licensees thereof, should have to defend a protracted antitrust suit where the damages claimed are three times the amount of the royalties anticipated from possible licensees under the valueless patent.

The objective of *Lear* was to "unmuzzle" licensees and to give them the necessary incentive to challenge patent validity, so that "the public may [not] continually be required to pay tribute to would-be monopolists without justification" (p. 670). To subject licensees to antitrust actions based exclusively on the patent they may succeed in invalidating, as the Court below has done, would more than nullify the incentive specifically bestowed by *Lear*, i.e., an immunity from suit on the licensee's own agreement. It would be a strong disincentive to any licensee challenge of patent validity.

CONCLUSION

For the foregoing reasons, it is respectfully requested that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 15, 1976

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Civil Action No. 70 C 2350

MORAINE PRODUCTS, INC., a corporation, *Plaintiff,*
v.
ATLAS CHEMICAL INDUSTRIES, INC., et al., *Defendants.*

Minute Order Relating to Directed Verdict

(March 27, 1975)

Further evidence heard for plaintiff, and plaintiff rests. Argument on defendants' motion for directed verdicts on Counts 1, 2 & 3 continued and taken under advisement. Court grants motions in part, on ground that contract dated Jan. 19, 1961 between the defendants is valid and does not violate anti-trust laws, but denies motion to extent plaintiff contends defendant Plough participated in causing defendant Atlas to rescind its pre-existing contract with plaintiff on Jan. 18, 1961. After conference, plaintiff cites no evidence in support of the latter contention & relies upon the violation evidenced by the contract of Jan. 19, 1961 and its enforcement, whereupon defendants' motions for directed verdict on Counts 1, 2 & 3 are granted in full.

Certification under F.R.C.P. 54(b) denied, severance of Plough's counterclaim denied & motion of Atlas to proceed on Count V with same jury denied. Trial adjourned and jury to separate under same instructions as previously, to resume on Plough's counterclaim on Friday, March 28, 1975 at 10:15 a.m.

ENTER:

/s/ THOMAS R. MCMILLEN
Thomas R. McMillen
Judge, U.S. District Court

In the United States District Court
For the Northern District of Illinois
Eastern Division

(Caption Omitted in Printing)

Excerpts from Transcript of Hearing Before Judge Thomas R. McMillen, March 27, 1975

The Court: * * * *

I have, in effect, directed a partial verdict on some of the issues, some of the affirmative issues of the plaintiff's.

Mr. Connolly: Would you direct a partial verdict on issues against the defendants before they have even put in their case?

The Court: No. I am not directing a verdict against you on the question of damage or on the question of the relevant market. I am denying your motion for a directed verdict on those particular points.

Mr. Connolly: I see.

The Court: I am granting it on the liability issue with the exception of the pre-January 19th, 1961 relationship between Plough and Atlas. (pp. 1293-94)

* * * * * * * * * *

The Court. Well, all I understand Mr. Eben to say is that they are not going to attempt to call my attention to any other portions of the record that may support the conspiracy charge, and that they have rested their case.

That does not mean that there is an end to the case. I have not directed a verdict on the narrow portion of the case that I indicated earlier this afternoon.

But if you have nothing to point out with respect to evidence of a conspiracy between Plough and Atlas prior to

January 19, 1961, it will follow that the verdict will be directed on that part of the case, also.

So, I understand you to be saying, therefore, that you have no evidence to point out on that issue.

Mr. Eben: Then you misunderstood me. I did not mean to convey that to the Court.

The Court: All right.

Mr. Eben: We say that there is a strong circumstantial case to show that, but even showing that, that it would not go to the charge which we allege in our complaint in Counts I and III.

The Court: In other words, you are going back to the statement that the conspiracy did in fact start on January 19, 1961, and is based upon the contract?

Mr. Eben: That is correct.

The Court: And if I find the contract to be valid, as I have, that your case is finished.

Mr. Eben: I think that is a fair statement. (pp. 1297-98)

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In the
United States Court of Appeals
For the Seventh Circuit

No. 75-1488

Moraine Products, *Plaintiff-Appellant,*
v.
ICI America, Inc., *Defendant-Appellee.*

Appeal from the United States District Court
For the Northern District of Illinois, Eastern Division

No. 70 C 2350

Thomas R. McMillen, *Judge.*

Argued December 2, 1975 — Decided June 18, 1976

Before Pell and Bauer, *Circuit Judges,* and Whelan, *District Judge.**

Pell, *Circuit Judge.* This is an appeal by plaintiff Moraine Products (hereinafter Moraine) from a judgement entered on a directed verdict in favor of defendant ICI America, Inc. (hereinafter Atlas) on Counts I, II, and III of Moraine's complaint after presentation to the jury of the plaintiff's case in chief. The three counts of Moraine's second amended complaint that were tried consisted of two antitrust counts and a count for alleged tortious interference with business relationships. Moraine's claim of injury

* District Judge Francis C. Whelan of the United States District Court for the Central District of California is sitting by designation.

under Section 4 of the Clayton Act, 15 U.S.C. § 15, was based on its ownership of Patent No. 3,422,189 (the Rider Patent), and it charged conduct violative of Section 1 of the Sherman Act, 15 U.S.C. § 1, relating to the licensing of the Feinstone patent, which was originally issued as Patent No. 2,951,011 on August 30, 1960, reissued on July 24, 1962 as Reissue No. 25,205, and which was owned at all pertinent times by Plough, Inc., a codefendant at the trial. Moraine's primary theory of recovery was that a license agreement between Plough and Atlas [1] of January 19, 1961, was illegal per se. Alternatively, Moraine contended that, even if the contract was not unlawful per se, the evidence established that the defendants had conspired or combined to impose an unreasonable restraint on commerce.[2]

The challenged agreement involved a grant by Plough to Atlas of a license stated to be exclusive except as to Plough itself and another licensee, the Block Drug Company.[3] The directed verdict in favor of the defendants,

[1] The agreement was actually one between "PLOUGH" and "STUART," as those terms were defined in the agreement. Since The Stuart Company was later acquired by Atlas Chemical Industries, Inc., which in turn was later acquired by ICI, America, Inc., this opinion will hereinafter in most instances use the more convenient reference to Plough and Atlas.

[2] The appellee argues that Moraine's counsel had advised the court that its entire case was premised on the alleged illegality of the Plough-Atlas 1961 license. Our examination of the trial record and statements of counsel therein satisfies us that while the primary thrust of the case presented may have been claimed per se illegality of the Plough-Atlas agreement, the alternative theory was not eliminated.

[3] The relevant portions of this agreement provided:

1. PLOUGH grants to STUART the right to use the Feinstone Invention and a license, exclusive except as against PLOUGH and Block Drug Company (as provided in Paragraph 6 hereof), in the United States, its territories and possessions, and non-exclusive in foreign countries, to make, use and sell com-

and the judgment entered thereon, were based on the trial court's conclusion that Moraine had failed to establish that the Plough-Atlas license agreement or the defendant's conduct incidental thereto had unreasonably restrained trade in violation of 15 U.S.C. § 1 or that the agreement or conduct constituted a tortious interference with any business relationship of Moraine. More specifically, the trial court directed a verdict on the "ground that [the] contract dated Jan. 19, 1961 between the defendants is valid and does not violate antitrust laws," and on the further ground that Moraine had cited no evidence in support of its contention that Plough had participated in causing defendant Atlas to rescind its pre-existing contract with Moraine on January 18, 1961.

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positions covered by said Letters Patent No. 2,951,011, any extension or reissue thereof. . . . STUART does not have the right under the license granted herein to sub-license in the United States, its territories and possessions the making, using or selling of said compositions or any of them; but STUART may grant sub-licenses to third parties in countries foreign to the United States and its territories and possessions. . . .

2. PLOUGH reserves the right of PLOUGH to use the Feinstone Invention and to make, use and sell compositions covered by said Letters Patent No. 2,951,011, any extension or reissue thereof, covered foreign patents, or any improvements, but except as to Block Drug Company as provided in Paragraph 6 hereof . . . PLOUGH will not grant to any third party a license to make, use and sell said compositions or methods of using them in the United States, its territories and possessions.

* * *

6. PLOUGH may grant a license under the patents . . . to Block Drug Company of Jersey City, New Jersey. PLOUGH will exercise its best efforts to limit license to Reed & Carnrick Division of Block Drug Company and to their product known as "Phazyme". . . .

Other provisions in the contract make clear that the terms "PLOUGH" and "STUART," as used in the agreement, included controlled companies, present and future, of Plough, Inc. and The Stuart Company. See Note 1, *supra*.

I. The Major Transactional Facts

Some time during the 1950's, Dr. J. Alfred Rider, a gastroenterologist in San Francisco, California, began research work with a composition containing methylpolysiloxane (MPS) and finely divided silica [4] for the relief of gas or flatulence in human beings. Also during the 1950's, Dr. Wolffe Harry Feinstone filed a patent application for a simethicone-containing composition for the relief of flatulence in humans.

In 1958, Moraine Products was incorporated for the purpose, among others, of promoting Rider's invention. In August 1958, Stuart approached Rider and expressed an interest in marketing deflatulent products embodying his invention. On March 11, 1960, Stuart entered into an agreement with Rider and Moraine. Under that agreement, Stuart was to pay a 5% royalty on its sales of simethicone-containing products in return for an assignment of Rider's alleged invention, including his United States and foreign patent applications thereon. The agreement was to be effective whether or not a U.S. patent was obtained.

Early in 1960, Stuart began marketing a deflatulent product called Mylicon, which contained MPS plus finely divided silica, *i.e.*, simethicone, in accordance with Rider's invention. On August 30, 1960, the Feinstone patent was issued. This patent had both method and product claims covering the treatment of gastrointestinal distress through the use of any antacid material coated with an organopoly-siloxane.

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[4] Use of the term "simethicone" to describe the combination of MPS and finely divided silica has developed in the media advertising of Di-Gel, one of the products in this case. As advertisements have noted, simethicone is the only product recognized by the Food and Drug Administration as safe and effective for relieving gas in humans. The author will use the term "simethicone" rather than the term "Antifoam A," which was the name used by Dow Chemical Company for the identical composition, which was earlier used to relieve cattle bloat.

While the claims of the Feinstone patent were not directed to the identical invention covered by the Rider application, Stuart became concerned about its marketing position. Feinstone and Plough, with which corporation he had become associated, advised Stuart that its Mylicon infringed Feinstone's recently issued patent.

After months of correspondence and meetings, both with Rider and Plough, Stuart rescinded its 1960 agreement with Moraine on January 18, 1961. On the next day, January 19, 1961, Stuart signed the previously mentioned patent licensing agreement with Plough. Moraine subsequently brought suit against Stuart (Atlas) for its termination of the 1960 agreement. In June 1962 that suit was settled upon terms which, among other things, granted Atlas an option to obtain exclusive licenses for itself or others under any Rider patent that subsequently issued on his then-pending patent application.

After ten years of patent prosecution, the Rider patent issued on January 14, 1969. Within the thirty days provided in the settlement agreement of June 28, 1962, Atlas exercise its right to obtain an exclusive license under the Rider patent. Shortly thereafter, upon receipt of a letter of demand from Atlas, Moraine sued Plough and Block for patent infringement, the suits eventually being consolidated in the Northern District of Illinois. Thereafter in mid 1970 Atlas sued Moraine in the Eastern District of Michigan seeking, among other things, a declaratory judgment that the Rider patent was invalid. Since the patent suits were filed at approximately the same time as this antitrust suit, pretrial discovery proceeded essentially on a consolidated basis. The evidence developed for purpose of the patent suits was utilized in the present antitrust action.

The patent litigation has proceeded to a final judgment. In *Atlas Chemical Industries, Inc.* v. *Moraine Products, Inc.*, 350 F. Supp. 353 (E.D.Mich. 1972), *aff'd in part, rev'd in part,* 509 F.2d 1 (6th Cir. 1974), Atlas secured a final adjudication that the Rider patent for the use of simethicone for the relief of gastrointestinal gas and flatulence in humans was invalid. The reported opinions of the Michigan district court and of the Sixth Circuit set forth the essential narrative details and provide a contextual background for the present litigation and need not be repeated here.

The issues in this appeal are numerous and, at least as presented, are complex. Although Atlas filed a cross-appeal, this was withdrawn two days before its answering brief was filed. Some of the issues raised in the answer brief suggest the possibility that as a tactical matter the appellee has determined to present contentions which might more properly have been raised by the cross-appeal resulting from the trial court's striking of certain defenses and counterclaims. We regard the basic issue in this appeal as being whether the district court should have granted a directed verdict; and, being mindful that in considering the correctness of trial court action on review we are not necessarily confined to the reasons advanced in the trial court for the purpose of sustaining the action, we will consider the various contentions of the appellee only to the extent that they would justify the directed verdict. We find little reason for becoming involved in the eristic briefing pertaining to the scope of the decision of the litigation in the Sixth Circuit.

II. The Plough-Atlas Licensing Agreement

The first aspect of the main issue is found in a matter which appears to be of first impression and is whether it is a per se violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, for the assignee of a patent in licensing a competitor to agree with that competitor that with the exception of another competitor the assignee will not license anyone else although retaining the right to use the

patent itself and the first licensee will not grant any sublicenses. The effect of the Plough-Atlas agreement which embodies the above commitments is that further licensing under the patent can only be accomplished by joint agreement between the two signatories of the licensing agreement.

Moraine contends, that under *United States* v. *Krasnov*, 143 F.Supp. 184 (E.D.Pa. 1956), *aff'd. per curiam*, 335 U.S. 5 (1957), *petition for rehearing denied*, 355 U.S. 908, the January 19, 1961 agreement between Plough and Atlas was illegal. Undergirding the present question, in part, at least, are the competing philosophies of patent and antitrust champions. The speeches and articles of governmental antitrust officials have expressed the view that the days of benign neglect towards restrictions on competition by patentees should be numbered. See M. Adelman & F. Juenger, *Patent-Antitrust: Patent Dynamics and Field of Use Licensing*, 50 N.Y.U.L.Rev. 273, 274 (1975).

At a panel discussion on patent licensing in August 1973 Bruce B. Wilson, then Deputy Assistant Attorney General, Antitrust Division, stated quite candidly:

> . . . [T]he Department believes it to be unlawful for a patentee to agree with his licensee that he will not, without the licensee's consent, grant further licenses to any other person. That is the old *Krasnov* principle. 42 ANTITRUST L.J. 683 (1973).

At the same meeting, George Frost, Director of the Patent Section of General Motors, while presenting his own views on matters of patent policy, noted the stringent applications of 15 U.S.C. § 1 and observed:

> Another class of cases involves restrictive license provisions for the benefit of the licensee. For example, a license veto power over the grant of future licenses has been held illegal. [citing *United States* v. *Besser Mfg. Co.*, 96 F.Supp. 304 (E.D.Mich. 1951), *aff'd*, 343 U.S. 444 (1952); and *Krasnov, supra.*] Such restrictions on the patentee's conduct can hardly be considered a part of the right of the patentee to exclude others.

Address by George E. Frost, *Restrictions on Fields of Use and Territories*, Annual Meeting of the Antitrust Section of the American Bar Association, Aug. 7, 1973, in 42 *id*. 633, 636-37.

Although officials of the Antitrust Division have indicated the view stated above, recent filings of civil actions challenging the validity of licensing practices apparently reflect diffuse approaches, so that commentators find difficulty in uncovering "any consistent theories that might guide patentees, licensees and their counsel in structuring licensing programs." Adelman & Juenger, *supra* at 300-01.

In sum, patent and antitrust champions have debated for a number of years the reach of such cases as *Krasnov* and *Besser*. While Moraine argues that these cases require a conclusion that the Plough-Atlas agrement was illegal, Atlas contends that such cases as *United States* v. *Singer Mfg. Co.*, 374 U.S. 174 (1963); *Virtue* v. *Creamery Package Mfg. Co.*, 227 U.S. 8 (1913); *Bement* v. *National Harrow Co.*, 186 U.S. 70 (1902); *LaSalle St. Press, Inc.* v. *McCormick & Henderson, Inc.*, 445 F.2d 84 (7th Cir. 1971); *Bela Seating Co.* v. *Poloron Products, Inc.*, 438 F.2d 733 (7th Cir. 1971), *cert. denied*, 403 U.S. 922; *Cataphote Corp.* v. *DeSoto Chemical Coatings, Inc.*, 450 F.2d 769 (9th Cir. 1971), *cert. denied*, 408 U.S. 929 (1972); and *Mechanical Ice Tray Corp.* v. *General Motors Corp.*, 144 F.2d 720 (2d Cir. 1944), *cert. denied*, 324 U.S. 844 (1945), support its position that the challenged agreement was perfectly legal.

Although Atlas so argues to this court, its officers gave testimony concerning their awareness that there was an

"antitrust problem" regarding the challenged agreement. Atlas now presses its view that the January 19, 1961, agreement was an exclusive but not sole license. It correctly notes that this court has recognized, in *Flexwood Co.* v. *Faussner & Co.,* 145 F.2d 528, 539 (7th Cir. 1944), that an exclusive license may involve more than a single licensee. It points to the above cited cases where the courts have approved licenses at least analogous to that under challenge in this case.

We think that the implicit premise of the Atlas argument is that it should not be penalized for entering an agreement in earlier years when the decisional law upheld its validity. As so construed, there is some persuasive force to the argument. An examination of the cases cited by Moraine and Atlas causes us to conclude that none of them is controlling on the question of per se illegality. *Krasnov* involved pooling of patents, price fixing and the institution of punitive infringement suits for the purpose of harrassment rather than with the intention that they be adjudicated on the merits. In *Besser,* the conspiracy involved pooling of patents, an agreement to pool future improvement patents, interlocking directorates, the use of improper influence on suppliers or competitors to curtail their output, and recklessly made threats of suit. Each of the leading cases cited by Moraine in support of its theory of per se illegality involved a broad spectrum of anticompetitive conduct on the part of the defendants.

Resort to the writings of both patent and antitrust specialists provides a framework for judicial analysis but does not effectively resolve the basic question here presented. The precise contours of the Antitrust Division's belief as indicated above have not been traced either in test litigation or in a series of decided cases. A former chief of the Antitrust Division, the late Judge Richard McClaren, once stated his conclusions regarding *Krasnov:*

> One of my predecessors suggested—and I think rightly—that the rule of *Krasnov* should be extended to make unlawful any sole or exclusive license without sublicensing rights. 5 CCH TRADE REG. REP. ¶ 50,106, at 55,123 (1972).

Of course, the suggestion that the rule *should be extended* impliedly reflects a discerning awareness that the decision itself did not have unlimited reach. The absence of any exacting analysis of the precise nature of the views of the Division, which this court although not bound thereby would respectfully consider, is but one of the factors which makes this court hesitate in accepting Moraine's reading of the outer reaches of the Supreme Court's per curiam opinion.

Whatever may have been the view of Division officials at an earlier time, the current legal literature contains at least one hint that the present view of the Antitrust Division is not consistent with a conclusion of per se illegality. The Department of Justice has recently announced that it will not oppose a proposed patent licensing agreement between the Salk Institute for Biological Studies and several pharmaceutical companies for the clinical testing and commercial development of somatostatin, a drug which Salk believes may be useful in treating certain forms of diabetes and other diseases. *See* "Antitrust Division Okays Salk Patent Licensing Plan," 745 ATRR at A-16 to A-17 (January 6, 1976).

The Salk Institute is a public, nonprofit foundation which performs basic biological research in its laboratories. It is supported primarily by grants from United States Government agencies and private charitable contributions. The Institute owns a patent and two pending patent applications for somatostatin and analogs thereof, but it lacks the necessary facilities and financial resources for clinical testing. It is estimated that the average cost of

bringing a new drug to the market exceeds 10 million dollars.

In order to induce qualified pharmaceutical firms to conduct the necessary clinical testing of somatostatin and to obtain royalty income to fund current as well as new research, the Institute proposed to license commercial pharmaceutical firms to manufacture and sell somatostatin. One of the terms of the option agreements is a commitment by Salk to limit its initial licensing to five worldwide nonexclusive licensees, no more than two of which shall be granted to United States firms and no more than three to European firms. These limitations would apply with respect to each country until three years after the first sale in that country by a licensee to the general public of any product covered by the patent, except that Salk would be free to grant further non-exclusive licenses anywhere in the world three years after the first such sale in the United States.

In a letter dated December 16, 1975, Acting Assistant Attorney General Bruce B. Wilson explained that although the Antitrust Division generally believes that an agreement among the licensor and its prospective licensees to limit the number of licenses is probably anticompetitive, the Institute has shown that such a limitation is the least anticompetitive way to develop somatostatin on reasonable terms. Wilson also stated that the temporary limitation on the number of licensees appeared to be reasonable because Salk had been unable to obtain license agreements with qualified and interested firms without such a limitation. *Id.* at A-17.

Even if this court assumes that Salk's use of nonexclusive licenses distinguishes the proposed licensing arrangement from that involved in the marketing of simethicone-containing deflatulents by Atlas and Block as exclusive licensees, it is difficult to reconcile the Division's approval

of the Salk plan with an inflexible reading of either *Besser* or *Krasnov*, since the latter case involved the grant of a nonexclusive license to make, use and sell slip covers. 143 F.Supp. at 192.

While we may at this point conclude that the reach of *Krasnov* should not have an unlimited extension, argument for some extension retains strength. An analysis of the situation appears in R. Nordhaus & E. Jurow, Patent-Antitrust Law, § 122 at 434-35 (2d ed. rev. 1972), which is summarized in the following three paragraphs of this opinion.

An absolute exclusive license prevents the licensor from granting any license other than the immediate one. The grant of a license accompanied by a covenant that the licensor will not grant any other licenses without the consent of the immediate licensee permits the licensor to grant other licenses under the specified conditions. Arguably, a license of the latter character has a less severe effect on competition than the absolute exclusive license. The frailty of this argument is that it overlooks the practical operation of this type of limited exclusive license.

Where the patentee or his assignee has granted an absolute exclusive license, the exclusive licensee usually has the authority to grant sublicenses. An applicant for a sublicense can secure one by obtaining the consent of the exclusive licensee. Where the patentee or his assignee has granted a nonexclusive license, under which the licensor retains the power to grant other licenses, an applicant for a license can secure one by obtaining the consent of the licensor. In either case, therefore, an applicant may obtain a license under the patent by meeting the requirements of only a single party.

The case of a limited exclusive license is strikingly different. Here, the applicant must secure the consent of the two parties, the licensor and its immediate licensee. This

arrangement, which requires joint action of two parties before an applicant can secure a license, permits undesirable applicants to be boycotted through concerted action. Thus,

> [u]nder the general principle that, although a patent owner acting alone may refuse to license anyone, it can not refuse to grant a license when the refusal is pursuant to a conspiracy or combination, it would appear that a limited exclusive license of the type in question is objectionable under the antitrust laws. Nordhaus & Jurow, *supra* at § 122, at 434-35. (Footnote omitted.)

The objectionable nature of the limited exclusive license rests basically upon an analysis of the anticompetitive possibilities that such a licensing scheme presents. The authors whose analysis we have paraphrased go on to observe, citing, inter alia, *Krasnov* and *Besser,* that the issue remains unsettled.

It would appear, of course, that the issue had been settled if, as Atlas contends, and the district court apparently thought, the challenged agreement was perfectly legal. We have earlier herein cited the cases on which Atlas relies in this regard. In our opinion none of the cited cases are directly dispositive of the present issue, but because of the breadth of language in the cases we deem it necessary to discuss the principal ones.

The seminal case is *Bement* v. *National Harrow Co.,* 186 U.S. 70 (1902). In that case, the Supreme Court held that there was nothing which violated the Sherman Act in the agreement between the parties that National would not license any other person than Belmont to manufacture or sell any harrow of the peculiar style and construction then used or sold by Bement. At first reading, the case seems to support the argument of Atlas that the Supreme Court has ruled on the legality of its license agreement. There can be no question that the Court stated that, apart from some

exceptions, "the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States." *Id.* at 91.

The holding in *Bement,* however, must be read within the context of the procedural status of that case. The Court was limited in its review by the findings of fact made by the referee, who had omitted to find from the evidence that there were in fact other manufacturers of harrows who had entered into the same kind of contracts with National. Because its review was limited to the findings of fact which had actually been made, the Court concluded its opinion:

> If such similar agreements had been made, and if, when executed, they would have formed an illegal combination within the act of Congress, we cannot presume for the purpose of reversing this judgment, in the absence of any finding to that effect, that they were made and became effective as an illegal combination. As between these parties, we hold that the agreements A and B actually entered into were not a violation of the act. We are not called upon to express an opinion upon a state of facts not found. *Id.* at 95.

In view of this language, *Bement* cannot be read as expressly sanctioning the agreement or conduct of either Plough or Atlas. In the present case, there is the additional fact, supported by the evidence, that Plough licensed Block Drug Company, but did not allow Block (through its wholly owned subsidiary Reed & Carnerick) "to sublicense either in the United States or in foreign countries . . . ," and that both Plough and Atlas contemplated, at the time of their agreement, that only one other limited license would be granted under the Feinstone patent.

Moreover, the Supreme Court's language expressly recognized that there were exceptions to the general rule of absolute freedom in the use or sale of patent rights. It begs the question raised in this appeal to assert that one

of this court's decisions, *viz.*, *Bela Seating Co.* v. *Poloron Products*, 438 F.2d at 739, recognized a general rule of freedom. This court's decision did paraphrase the language of *Bement*, but it did so in the context of a claim of discrimination in royalty rates charged to undifferentiable competitors under a patent. That case was much different from the present litigation, and it did not confront the question of whether the assignee of a patent could agree with a competitor that no further licenses would be granted without its consent.

Similarly, there is nothing in *Virtue* v. *Creamery Package Mfg. Co.*, 227 U.S. 8 (1913), that relates directly to the present issue. In that case, the Supreme Court ruled that the Owatonna Company and the Creamery Package Manufacturing Company, its exclusive sales agent, did not violate the Sherman Act by bringing infringement suits against D. E. Virtue, one of the joint inventors of a churn and butter worker. A necessary element in Virtue's charge of an antitrust violation was the cooperation of the corporate defendants in bringing the infringement suits. Apart from the formal contracts, Virtue focused on the coincidence in time of the suits as proof of concerted action on the part of the defendants and of a conspiracy to destroy the business of the plaintiffs. 227 U.S. at 37. The Court found this contention untenable, and ruled that the provision in the contracts for the prosecution of infringement suits was but an assurance of the rights conveyed in valid contracts. The Court found it unnecessary to analyze or to discuss particular covenants in the "very elaborate and verbose" contract, *id.* at 26, and its statement that patent rights might be conveyed partially or entirely and that the monopoly of use, of manufacure or of sale was not condemned by law must be read in the light of the actual Court analysis.

The district court although recognizing that the holding in *United States* v. *Singer Mfg. Co.*, 374 U.S. 174 (1963),

had no bearing on the issue before it nevertheless found support in a paragraph of the Court's opinion specifying what was not involved in the case before it. We find no basis of disposition of the issue before us in this negative paragraph other than the general proposition, with which we certainly do not quarrel, that the very purpose of patenting inventions is to furnish substantial exclusive rights to the holder of the patent. Nor do we find any of the other cases relied upon by Atlas determinative of the issue before us. While the cases in varying degrees contain language pointing to a conclusion that patent holders have broad freedom in licensing, we are not aware of any language specifically creating a theory of unswerving supremacy of patent law over antitrust law nor establishing in a patent licensing situation an absolute immunity from antitrust law.

Likewise the relevant statute provides no definitive answer. 35 U.S.C. § 261 provides in relevant part:

> The applicant, patentee, or his assigns or legal representatives may in like manner [by an instrument in writing] grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.

From a historical standpoint, it appears that the quoted language was originally intended to apply to neither assignments nor licenses, but rather to what were classified as "grants" in the nineteenth century. There is a technical distinction between a grant, an assignment, and a license. A historical and literal reading of the statute points to the conclusion that the section does not really apply at all to patent licenses.[5] Or, as it has been expressed more recent-

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[5] For a succint discussion of the history of 35 U.S.C. § 261 and its precise literal meaning, see Marquis, *Limitations on Patent License Restrictions: Some Observations*, 58 IOWA L. REV. 41, 55-57 (1972).

ly, "Patent licenses are not governed by the Patent Act, Section 261 being inapplicable to licensees." P. Rosenberg, Patent Law Fundamentals 264 (1975).

Even though the statutory section is not directly applicable, this court recognizes that the difference between a "grant" and an exclusive license is merely formal in nature. The litigation has been complicated by a continuing dispute over the nature of the license granted by Plough to Atlas. Moraine characterizes the challenged agreement as creating a non-exclusive license, probably because the leading cases undergirding its per se theory have involved a non-exclusive licensee agreeing not to sublicense. Atlas contends that it is indeed an exclusive licensee, subject to a reserved right in the licensor to grant a non-exclusive license to a third party. We hold that Atlas is an exclusive licensee.

However, this holding does not help in the resolution of the issue in this appeal. Nothing in 35 U.S.C. § 261 or the decided cases sanctions an arrangement wherein competitors agree with one another that they will not grant further sublicenses. The bare language of § 261 does allow a patentee or his assignee to grant an exclusive license to make, use, or sell the patented invention. But the statutory language must be construed in connection with antitrust law.

The provision of the Sherman Act prohibiting every contract, combination or conspiracy in restraint of trade or commerce among the several states is literally all encompassing, but courts have construed it as precluding only those contracts or combinations which "unreasonably" restrain competition. *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958). Some business arrangements, such as price-fixing agreements, division of markets among competitors, tying arrangements, and group boycotts, have such an obvious effect on competition that they are conclusively presumed to be illegal; *i.e.*, they are per se violations of the Act. *Mogul v. General Motors Corp.*, 391 F.Supp. 1305 (D.C.Pa. 1975). Where activity allegedly in violation of

antitrust law has not been held per se violative of Section 1 of the Sherman Act, the traditional "Rule of Reason" analysis has been held applicable. Generally speaking, such analysis involves, inter alia, a study of the consequences of the conduct on the affected market before imposition of antitrust sanctions. See *George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 508 F.2d 547, 559 (1st Cir. 1974), *cert. denied*, 421 U.S. 1004 (1975).

The patent structure of the drug industry is peculiar in several respects, H. Miller, *Patent License Restrictions in the Prescription Drug Industry*, 53 Va. L. Rev. 1283, 1292 (1967), and license restraints of many defined types are quite common in the pharmaceutical industry. Adelman & Juenger, *supra* at 299. A considerable body of literature has developed regarding field-of-use restrictions, and expert commentators have suggested that a desirable policy of enforced patent insecurity can be effectuated, and competition restimulated, by adopting a limited number of rules that would classify patent licensing practices in the drug industry, at least for antitrust purposes, in accordance with their propensity to suppress patent attack by licensees. *Id.* at 305.

The record in this appeal does not give the court the information it would need in order to undertake the kind of economic and policy analysis which should properly undergird any determination to add to the pantheon of prohibited per se practices. "The correct economic evaluation of patent-licensing arrangements under patent law or antitrust law, as with similar arrangements when patents are not involved, is a complicated process and deserves careful analysis. . . ." W. Bowman, Patent and Antitrust Law: A Legal and Economic Appraisal xi (1973). The substantial acceptance, by both the legal and economic professions, of proscriptive judicial opinions relating to licensor-licensee contracts under both patent and antitrust law cannot substitute for critical analysis in search of better answers to the relevant policy questions. *Cf. id.* at 255-56.

We cannot fault the district court for its apparent unwillingness to find a per se violation. The strict per se rules of modern antitrust law establish a conclusive presumption that a particular kind of action has improper anticompetitive effects, and this presumption governs regardless of whether the particular conduct in its actual context has been proved to have those consequences. *Carter-Wallace, Inc.* v. *United States,* 449 F.2d 1374, 1381 (Ct.Cl. 1971). Courts impose these presumptions where they have had sufficient prior experience with a type of action to feel justified in concluding that previously discerned anticompetitive effects will always, or nearly always, be present once the existence of a practice is shown or where, even without that actual experience, the court reaches the same conclusion through analysis. *Id.* In sum, per se rules are judicially created to deter agreements or practices which constitute unreasonable restraints on trade or which have such a pernicious effect on competition and so lack any redeeming virtue that a declaration of illegality can be made without elaborate inquiry into the precise harm they cause or the business excuse for their use. *E.g., United States* v. *Topco Associates, Inc.,* 405 U.S. 596, 607 (1972); *White Motor Co.* v. *United States,* 372 U.S. 253, 262 (1963); *Northern Pacific, supra* at 5.

No doubt it is possible for manufacturers to draft specific patent license terms so as to insure the cooperation of licensees in effecting anticompetitive ends. See Marquis, *supra* at 50. Where a challenge is made to a particular form of restrictive licensing, the analytic problem is to uncover a readily accessible and reliable indicator of the anticompetitive tendencies of particular license agreements. See *id.* at 93. Many types of license agreements can have an adverse effect upon competition, but it is questionable whether the traditional judicial focus on specific license restrictions rather than on the entire competitive setting surrounding the licensing of patents represents the preferable method of balancing antitrust and patent policies. See *id.* at 90.

Where licensing practices suppress incentives to attack patent validity, to invent around the patent, or to employ available technology, they can hardly be considered a legitimate exercise of patent rights immune from antitrust scrutiny. Adelman & Juenger, *supra* at 296. Economic analysis suggests that the licensor's business interest is often not advanced by licensing all applicants. Antitrust decisions have sometimes stringently regulated patent licensing contracts which are efficient not only in the economic but also in the social sense. *Cf.* Bowman, *supra* at 241. A licensor is not always able to recoup the profits surrendered to competing licensees, Adelman & Juenger, *supra* at 298, and it is not difficult to see that the apprehension of such a possibility would exert influence upon the decisions of sophisticated businessmen.

Where a patent license is used to protect the licensee in addition to the patentee or is used to allow the licensees to divide a market among themselves, thus enabling them jointly to regiment an industry under the guise of a patent license, there is good reason to declare such a restrictive scheme illegal. Miller, *supra* at 1301. Although not left unchallenged, there is evidence in the record pointing to the conclusion that Atlas, Plough, and Block conspired to divide the market for simethicone-containing antacids among themselves. Similarly, there is an evidentiary basis for Atlas' assertions of sound commercial grounds for its desiring the challenged patent license and consistently pressing Plough for its literal enforcement.

On such a record, the erection of a judicial presumption that the challenged license agreement was pernicious or totally lacking any redeeming economic virtue is unwarranted. The continuing debate between patent and antitrust champions has not so conclusively established the anticompetitive purpose or effect of a mutual agreement

not to grant sublicenses that this, or any other court, can properly eschew economic analysis and rule a priori that, upon execution, the January 19, 1961, license contract was illegal per se. Such a narrow focus on the specific terms of a licensing arrangement would ignore the body of sophisticated legal and economic literature to the effect that truncated judicial vision has frequently upset desirable commercial practices. It would draw a line differentiating legal and illegal practices upon a presumption not fairly drawn from the factual realities of drug research and marketing. Thus, the district court's refusal to find per se illegality in the challenged agreement was not erroneous.

On the other hand, this court is not prepared to take the additional step and to conclude, as Atlas insists it should, that the 1961 licensing arrangement was entirely lawful. Such a conclusion would circumvent completely an application of the traditional "Rule of Reason" analysis. Accordingly, it is necessary to examine Moraine's argument that the evidence it presented established, at least on the record, sufficient facts to present a jury question as to an antitrust violation by Atlas. It is not necessary for this court itself to conduct the "Rule of Reason" analysis if it determines that the trial court erred in its entry of judgment. Upon a finding of trial court error in this regard, a remand for further proceedings would provide the mechanism for the proper reconciliation of patent and antitrust policies.

Only unreasonable restraints of trade or commerce are within the prohibition of the Sherman Act. *Standard Oil* v. *United States*, 221 U.S. 1 (1911). Since not all contracts among potential competitors are prohibited, at some time in the course of litigation in the absence of a per se violation there must be applied a "Rule of Reason" analysis, which includes consideration of the facts peculiar to the business in which the restraint is applied, the nature of the restraint and its effects, and the history of the restraint

and the reasons for its adoption. See *Topco Associates*, *supra* at 607. It is well established that only those acts, contracts or agreements which unduly obstruct the due course of trade, or which injuriously restrain trade because of their inherent nature or effect, or because of their evident purpose are unlawful under the "Rule of Reason." *E.g.*, *Kestenbaum* v. *Falstaff Brewing Corp.*, 514 F.2d 690 (5th Cir. 1975), *cert. denied*, —— U.S. ——, 44 U.S.L.W. 3493 (1976).

III. Correctness of a Directed Verdict

A. Scope and Standard of Review

The function of this court in reviewing the propriety of a directed verdict is to examine the entire record to determine whether there were any jury questions. *Stief* v. *J.A. Sexauer Mfg. Co.*, 380 F.2d 453 (2d Cir. 1967), *cert. denied*, 389 U.S. 897. There is no dispute between the parties concerning the test applicable in this case. The rule that, upon motion for a directed verdict, the evidence must be viewed in the light most favorable to the party against whom the motion is made and that the opposing party must be given the benefit of all inferences which the evidence fairly supports, even though contrary inferences might reasonably be drawn, governs rulings upon motions for directed verdict in treble damage suits under the antitrust laws. *Continental Ore Co.* v. *Union Carbide & Carbon Corp.*, 370 U.S. 690, 696 n. 6 (1962).

While Atlas argues that the trial court correctly determined that there was no unreasonable restraint of trade under any circumstances, per se or otherwise, we do not read the decision under review as sufficiently addressing the "otherwise" aspect. In essence, it appears to us that the district court went no further than determining that the authorities hold that an owner of a patent has the right to grant an exclusive license if it so desires and, having engaged in such legal conduct, it has not violated

the antitrust laws. Although the trial court recognized the unsettled state of the law and concluded, as have we, that Moraine had not established a per se violation, we do not find any basis for determining that there was any "Rule of Reason" analysis. No written opinion was provided by the trial court, and we have had to reach the conclusion that we have on the basis of bench pronouncements.

We turn then to an analysis of the evidence in discharge of our function to determine if a jury, properly instructed in the law, could properly determine from the evidence, including the drawing of permissible inferences, that Atlas had violated the prohibitions of the Sherman Act.

We note at the outset that the focus of analysis need not be exclusively on the execution of the January 19, 1961 license agreement. Every patent license agreement is literally a contract and combination, but no formal agreement need be shown in order to establish an antitrust violation. Indeed, well counselled restraint-combiners could scarcely be expected to put or leave in their files detailed written documentation of their illegal purposes which, of course, does not mean that they might not resort to documentation of the "window-dressing" type. On a review of the instant record, we conclude there was evidence from which a jury could infer that, even prior to the formal execution of the challenged contract, there already was some form of agreement the effect of which would be to limit in numbers those catering to the needs of the substantial market of customers plagued with flatulopetic symptoms.

Many months before the execution of the license, Plough became aware of Stuart's activity in marketing its Mylicon deflatulent. Shortly thereafter, a meeting was held between the presidents of the two companies. During the course of the fall and the early winter of 1960-61, there were a number of meetings and the exchange of letters. For commercial reasons, Stuart wanted an exclusive license under the Feinstone patent. Both Plough and Stuart felt that the license should be limited to the two companies. In a letter of October 25, 1960, Stuart wrote Plough, stating:

> We hope that in view of *your and our plans* to retain such products exclusively within Plough and Stuart effective measures can be taken to stop Reed & Carnrick as well as any others. (Emphasis added.)

The factual background of this letter was that Stuart had become aware that Reed was marketing a simethicone-containing deflatulent called Phazyme. The expression of assertedly mutual *plans* to gain exclusive rights in simethicone-containing antacids raises the possible inference that the two companies were already combining for an anti-competitive purpose, even though the formal instrument constituting the license had not yet been executed.[6]

Also on October 25, 1960, Plough wrote Stuart regarding its draft of a licensing agreement. The letter permits an inference that there was already a tentative, inchoate agreement which left room for future changes:

> However, if there is anything in it that you feel requires rewriting or modification, please do not hesitate to make such modifications so that we can eventually come up with a mutually satisfactory instrument.

Although no instrument meeting the strict demands of the common law of contracts was yet in existence, the evidence of record permits an inference that the two companies were already combining to serve not merely the interests of careful license draftsmanship but the anti-competitive end of excluding others.

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[6] Throughout this discussion we are merely indicating that which a jury might have determined to be facts demonstrating illegal combination and do not intend in any way to indicate that such is what would have been found if the case had gone to the jury.

Nearly a month later, the representatives of the two companies met once again. The parties there agreed that, if Plough could not force Reed & Carnrick out of the market and if court action was the only alternative, Plough would be permitted to give Reed a license. Further, it was agreed that all other companies, and products of Reed other than Phazyme, would be contested in court. A proposed general agreement was reached covering the essential terms of the eventual 1961 license on November 22, 1960. A Plough letter of December 7, 1960, confirms that some understandings had been reached by late November:

> It was my impression [Dr. Feinstone] and Harry Solmson's [a Plough executive] that we had resolved the few items that required modification during the course of your visit as was *finally discussed and agreed upon* in Harry's office. Consequently, we have revised that draft to conform with our mutual understanding as of that time. (Emphasis added.)

As antitrust specialists have observed, courts often focus on a specific license restriction rather than on the entire competitive setting surrounding the licensing of patents. See Marquis, *supra* at 90 n.120. It is difficult to avoid concluding that the trial court failed to follow the salutary advice that

> [a] key point to keep in mind in investigating competition is that the patent license is often only one of many agreements between the licensor and licensee, ranging from sales contracts to other patent licenses. In spite of the importance of patent licenses, therefore, a more accurate appraisal of competition is obtained by considering all other agreements and dealings between the firms in conjunction with the patent license. Although the patent license may frequently make the greatest contribution, these other agreements are important not only for the specific restrictions they impose, but for their cumulative effect upon the behavior of competitors. *Id.* at 90.

On the present record, this court cannot confidently assert that a jury could not reasonably infer that there were oral agreements between Plough and Atlas prior to the formal execution of the patent license. Nor can this court proscribe, as a matter of law, the drawing of jural inferences that the mutual understandings aimed at anticompetitive ends.

Plough and Atlas acted diligently in preventing the entry of other competitors (except Reed & Carnrick) into the market for human deflatulent products. From the execution of the license agreement until the approximate date on which the present litigation was commenced, well over forty drug companies applied for licenses under the Feinstone patent. All were refused. Other than the original two licenses to Atlas and Block, no licenses were granted to any other company. A jury could reasonably infer that Atlas combined with Plough in forcing other simethicone-containing products off the market.

At all pertinent times, the only simethicone-containing products which remained on the market and were available to the public throughout the United States were those of Plough, Atlas, and Block, the alleged co-conspirators. Expert testimony based upon economic data was used by Moraine to show that the license restriction had a significant effect upon the relevant market. We are persuaded that a jury could infer that there was an actual restraint of trade.

The important question, of course, was whether any restraint of trade was unreasonable or whether, if a restraint existed, it was sanctioned by the federal law applicable to patents. This court holds that the combination of the license agreement impliedly calling for the joint consent of Atlas and Plough before additional licenses

would be granted, when taken in conjunction with the repeated refusals of either Atlas or Plough to grant any such sublicenses, represents conduct for which the patent statute provides no direct sanction. In the absence of any direct case law directly proscribing either the license terms or the conduct of Atlas and Plough, the ultimate question of the reasonableness of any trade restraints disclosed by the evidence was for the jury to determine.

Under *Fortner Enterprises, Inc.* v. *United States Steel Corp.*, 349 U.S. 495, 500 (1969), a plaintiff who cannot meet the standards necessary to bring into play the doctrine of per se illegality can "still prevail on the merits whenever he can prove, on the basis of a more thorough examination of the purposes and effects of the practices involved, that the general standards of the Sherman Act have been violated." In that case, the district court had granted summary judgment in favor of the defendants in a private antitrust action. Here, the district court directed a verdict for the defendants, and entered judgment thereon. In so doing, the trial court acted upon a mistaken reading of the case law and upon an unformulated analysis of the evidence. Since Moraine never abandoned its "Rule of Reason" basis for recovery, the action of the trial court was in error. Unless there are alternate grounds upon which the judgment in favor of Atlas can stand, this court must reverse the judgment as to the antitrust counts and remand for a new trial. We will in the next section of this opinion address ourselves to alternative grounds advanced by Atlas for affirmance.

A different situation exists with regard to Count II of Moraine's complaint. The Plough-Atlas negotiations of late 1960 took place within the context of Rider's application for a patent. During the negotiations, Stuart advised Plough that it was considering a rescission of the Moraine-Stuart agreement of March 1, 1960. On the basis of our review of the record, we conclude that the district court

properly ruled that Moraine had not produced sufficient evidence that Plough participated in the decision to rescind the Moraine-Stuart agreement. Inasmuch as Moraine and Atlas settled their controversy regarding this matter in the June 28, 1962, option agreement, the trial court's grant of a directed verdict on Count II was correct.

IV. Alternative Grounds for Affirmance

On appeal, a litigant is entitled to rely on any ground for affirmance, whether or not passed upon by the trial court. *Dandridge* v. *Williams*, 397 U.S. 471, 475 (1970). Atlas argues that there are many additional sound grounds upon which the district court could have either dismissed the complaint or granted a directed verdict against Moraine. We shall not discuss all eight of the grounds upon which Atlas relies. However, we think that at least three of the asserted grounds merit discussion.

A. Policy Aspects of the Antitrust Claims

A troublesome aspect of the continuance of this litigation arises out of the fact that the essence of Moraine's damage claim is a deprivation of royalties from the Rider patent during the several year period from the time of its granting until its judicially declared invalidity. Although there is some basis to an argument that the underlying policy of *Lear, Inc.* v. *Adkins*, 395 U.S. 653 (1969), points to a conclusion that Moraine, the holder of a patent subsequently determined to be invalid, should not be able to recover damages predicated in effect upon licensing royalties, we are not persuaded that such policy considerations override Moraine's rights under the antitrust laws. While there are paradoxical aspects of allowing recovery to arise from illegal interference with the sale of something which ultimately was proven to have no sales value, it cannot be said that there was no such value during the period of the presumptive validity of the patent. We are assuming, of course, the nonexistence of facts indicating knowledge on the part

of the patent holder of patent invalidity or bad faith otherwise. While Moraine was the holder of a presumptively valid patent, it could legally entertain the expectation, unless it had in some manner deprived itself thereof, of receiving royalties from licensing arrangements which in final analysis are agreements in which the licensee is purchasing the right to be free from infringement litigation, which Moraine did have to sell during the period of validity.

B. Moraine-Atlas Settlement of June 28, 1962

Moraine's suit against Atlas for damages arising from the January 18, 1961 rescission of the 1960 agreement was settled, and Atlas was granted an option to take an exclusive license under the Rider patent. When the Rider patent issued in 1969, Atlas exercised its right to take such a license. At that time, Atlas was already manufacturing and selling in the United States products covered by the Rider patent.

The gravamen of Moraine's complaint of injury is that, because potential licensees under the Rider patent also required a license under the Feinstone patent in order to practice the Rider invention, the combination unlawfully limiting licenses under the Feinstone patent necessarily limited the number of potential licensees under the Rider patent and deprived Moraine of royalty income. Atlas seeks to sustain the judgment in its favor by contending that the illegal agreement or conspiracy, if any, could not possibly have damaged Moraine. It rests this argument on a claim that, except for several narrow exceptions, the terms of its license from Moraine precluded Atlas from nominating additional licensees.

One thrust of the Atlas argument is that the 1962 agreement gave it the right to license itself or others and that once it had taken the license for itself it no longer had any legal right to license others. This approach puts great

significance on the use of the disjunctive "or," a semantical significance that we are not persuaded the parties ever intended. While ordinarily the construction of documents is a legal question, the language of the 1962 agreement sufficiently lacks clarity as to the claimed restrictive limitation as to justify the admission of testimony as to the actual intent of the parties. Here there was testimony from which the jury could infer that Atlas did have sublicensing rights.

In respect to the agreement, Atlas also contends that in any event it was limited to claimed infringers in nominating others for a license. We decline to accept this strained construction of the agreement.

C. Moraine's Standing to Sue

Atlas also argues that Moraine's claims for loss of royalties in Counts I and III of its amended complaint were inappropriately brought under the antitrust laws because Moraine lacks standing to sue. This same argument was made on several pretrial motions to dismiss, but the district court denied the motions upon the authority of *Congress Building Corp.* v. *Loew's, Inc.*, 246 F.2d 587 (7th Cir. 1957).

We are not persuaded that *Congress Building* is precisely analogous to this case. In that decision, a theatre lessor was allowed to bring antitrust charges against conspirators whose action allegedly reduced the plaintiff's revenues from a percentage lease of the theatre. Atlas rightly observes of the facts of *Congress Building* that the plaintiff there had a reasonable business expectancy to protect, *i.e.*, rental payments for its theatre lease. Here, it is contended that Moraine had not reserved any reasonable business expectancy for such royalties.

The resolution of the standing question necessarily interacts with the question of the precise legal effect of the 1962 agreement. If Moraine's agreement with Stuart contemplated additional licensees other than Atlas, the lack of

nomination of licensees by Atlas, taken in conjunction with its Plough agreement, could be the basis for the determination of injury to the plaintiff who would thereby have standing to sue. What we have said under the previous subsection of this opinion is applicable to the matter of the 1962 agreement relationship to the present question. Upon remand, the ramifications of the effect of the 1962 agreement upon the present and allied questions may have to be the subject of further factual exploration. Although we think *Congress Building* is factually distinguishable, we decline to hold on the record before us that Moraine had no standing.

D. Other Alternative Affirmance Arguments

We have examined the other grounds which Atlas claims were sufficient to justify either a dismissal of the complaint or a directed verdict in its favor. We are not persuaded that Rider's supposed fraud in the procurement of his patent represents a sufficient ground for affirmance. We think there was evidence from which the jury could infer that Rider perpetrated no fraud. In the related patent litigation to which this opinion has earlier referred, the courts suggested that Moraine and its principals satisfied "the highest degree of candor and good faith" required of those having dealings with the Patent Office. *Atlas Chemical Industries*, 509 F.2d at 8, quoting *Kingsland* v. *Dorsey*, 338 U.S. 318, 319 (1949). The parties disagree over the findings actually made by the Michigan court on this question, but the error of the trial court in taking this case from the jury makes it unnecessary for this court to set forth at this time the principles of collateral estoppel applicable to this asserted ground for affirmance.

V. Summary

The record does not give this court sufficient information with which to undertake the critical legal and economic

analysis which should precede the establishment of a new per se antitrust violation. We find no error in the district court's unwillingness to accept Moraine's theory that the Plough-Atlas license agreement of January 19, 1961, was a per se violation of the Sherman Act. However, the record establishes that the trial court never attempted the flexible "Rule of Reason" analysis. Nothing in 35 U.S.C. § 261 or in the decided cases expressly sanctions an arrangement wherein two competitors join together and agree that no further competitors may be licensed under a patent without the joint consent of the first two. The district court erred in directing a verdict on the antitrust counts in favor of Atlas, and in entering judgment thereon, because of its conclusion that the challenged license agreement was valid.

The district court correctly ruled that Moraine had not produced sufficient evidence to prove that Plough participated in the decision by Stuart to terminate its 1960 agreement with Moraine, and its directed verdict in favor of Atlas on the tortious interference with business relationships count (Count II) was not erroneous. The alternative grounds argued by Atlas to support the judgment below depend on the literal language of the June 28, 1962 option agreement, on policy arguments drawn from *Lear, Inc.* v. *Atkins*, *supra*, and on charges of fraud by Moraine and Rider. These asserted grounds commingle questions of fact, law, and policy. On this record, and viewed in the light of the applicable standard for the direction of a verdict, this court cannot ground an affirmance upon them.

The judgment of the district court is affirmed as to Count II of the amended complaint. As to Counts I and III, the judgment of the district court is reversed, and the cause is remanded for further proceedings not inconsistent with this opinion.

Affirmed in Part,

Reversed in Part and Remanded.

Nos. 74-1141-42

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ATLAS CHEMICAL INDUSTRIES, INC., *Plaintiff-Appellant, Cross-Appellee,*

v.

MORAINE PRODUCTS, *Defendant-Appellee, Cross-Appellant.*

APPEAL from the United States District Court for the Eastern District of Michigan.

Decided and Filed December 12, 1974.

Before PHILLIPS, *Chief Judge*, ENGEL, *Circuit Judge*, and MCALLISTER, *Senior Circuit Judge.*

PHILLIPS, *Chief Judge.* This is an appeal from summary judgment in a patent suit filed by a licensee (Atlas) against the licensor (Moraine), in which the District Court declared the licensor's patent No. 3,422,189 to be invalid. The District Court ordered that royalties which had been escrowed during the period in which the action was pending be paid over to the licensor, and assessed certain pre-litigation costs against the licensee. Reference is made to the decision of the District Court, reported at 350 F.Supp. 353 (E.D. Mich. 1972) for a discussion of the complex details of the prosecution of the patent application before the Patent Office, and for the details of the series of license agreements which were negotiated both before and after the issuance of the patent. We affirm the finding of invalidity, and reverse as to the escrowed royalties and pre-litigation costs.

This suit began as an action by Atlas Chemical Industries, Inc. (Atlas), a licensee, to declare invalid a patent held by its licensor, Moraine Products (Moraine). The action was

initiated on authority of *Lear* v. *Adkins*, 395 U.S. 653 (1969). The invention described in the licensed patent concerns the use in humans of a drug formula comprising a mixture of organo-polysiloxane and finely divided silica, marketed by Dow Chemical Company as Antifoam A. This composition, also known commercially as "simethicone," originally was used to treat cattle bloat. Dr. Joseph H. Rider, the patentee who assigned his patent to Moraine, discovered that this composition also could be used to alleviate flatulence or gas in the gastrointestinal tract of humans.

When Atlas originally sued to invalidate the patent it offered in its complaint to pay royalties into escrow during the pendency of the suit. The District Court so ordered. A total of $291,808 in royalties was paid in escrow.

Following extensive discovery by both parties, Atlas moved for summary judgment of invalidity on the basis that there was no genuine issue of material fact and that the patent was invalid because of a prior use. 35 U.S.C. § 102(b). Moraine filed a cross motion for dismissal of the complaint on account of the alleged "unclean hands" of Atlas. Moraine claimed that Atlas had known of the prior use which invalidated the patent, and had withheld that information from Moraine and from the Patent Office during the pendency of the patent application.

The District Court found that there was no material dispute of fact as to the prior use and granted summary judgment in favor of Atlas on the issue of validity. Moraine's cross motion was denied on the theory that the public interest precluded a dismissal, since to hold otherwise would be to validate an invalid patent by estoppel or misconduct. 350 F.Supp. at 456.

The District Court was convinced that the "unclean hands" defense raised by Moraine had its application in other areas. It was held that, even though no counterclaim had been filed, "[c]ertainly Moraine should be made as

whole as possible. Atlas should be required to pay damages to Moraine." *Id.* at 359. Certain costs and expenses which were incurred in procuring and defending the patent were assessed against Atlas in the sum of $139,495.40. The escrowed royalty payments, totaling $291,808, were also ordered paid over to Moraine.

I.

The first issue concerns the disposition of the case by summary judgment. We recently have treated summary judgment in patent cases in detail and have stated that this procedure "may be a useful tool in cases where the validity of a patent is involved" but that it "should be used sparingly." *Tee-Pak, Inc.* v. *St. Regis Paper Co.*, 491 F. 2d 1193, 1195-96 (1974).

In *Tee-Pak* we made the following comment concerning the statutory presumption of validity:

> "An additional consideration that is present in patent cases is the statutory presumption of validity. A patent is presumed valid and the burden of proving its invalidity rests squarely on the party challenging it. 35 U.S.C. § 282. Even though this presumption may be weakened by the failure of the Patent Office to consider all pertinent art, the degree by which it is weakened depends on a balancing of the pertinence of the newly cited art with the pertinence of the art considered by the Patent Office. Thus, unless the presumption has been destroyed, it is a relevant factor for the court to consider in ruling on a motion for summary judgment." 491 F. 2d at 1196.

Since the ground of invalidity asserted in the present case does not touch on any area of inquiry considered previously by the Patent Office, there are no balancing factors here which weigh in favor of the presumption in disposing of the motion for summary judgment.

After reviewing the record in the present case, even with the abundance of caution which is required in relation to summary judgment, we agree with the District Court that there "is "no genuine issue as to material fact," Rule 56, Fed. R. Civ. P., and that the patent is invalid for prior public use.

Under 35 U.S.C. § 102(b) a patent is invalid if "the invention was . . . in public use . . . more than one year prior to the date of the application for patent in the United States." "Public use" is defined as "any non-secret use of a completed and operative invention in its natural and intended way." *FMC Corp.* v. *F. E. Myers & Bro. Co.*, 384 F. 2d 4, 9 (6th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968); *see Dunlop Co., Ltd.* v. *Kelsey-Hayes Co.*, 484 F. 2d 407 (6th Cir. 1973), *cert. denied*, 415 U.S. 917 (1974); *Minnesota Mining & Mfg. Co.* v. *Kent Indus., Inc.*, 409 F. 2d 99, 100 (6th Cir. 1969).

The evidence in this case shows that the patent to the composition *per se* had been held by Dow Chemical Company, but that its utility had been limited essentially to the treatment of cattle bloat. Dow Chemical marketed this material under the name Antifoam A to Dr. Rider, one of the founders of Moraine and the patentee of the use of Antifoam A in humans. Prior to the time that Dr. Rider filed his application, and unknown to Dr. Rider, this same material was being sold to Leonard Bergstein, a pharmacist of Midland, Michigan. Since Dr. Rider's application was filed on January 2, 1959, patent invalidity could be proved by a public use prior to January 2, 1958. Our examination of the record convinces us that the District Court was correct in concluding that:

> "The record is without dispute that during the summer and fall of 1957 a druggist named Bergstein in Midland, Michigan, marketed Antifoam A prepared by the Dow Corning Corporation as a method of treating intestional gas in humans. It indicates without dispute

that prescriptions for this product were filled, sold and the product was used by patients in Midland prior to January 2, 1958." 350 F.Supp. at 355.

Moraine contends that Bergstein's use of the product was experimental and, therefore, did not constitute a prior public use. *See New Jersey Wood Paving Co.* v. *American Nicholson Pavement Co.* (reported as *Elizabeth* v. *Pavement Co.*), 97 U.S. 126 (1877).

In *Dunlop Co.* v. *Kelsey-Hayes Co., supra,* 484 F. 2d at 413-14, this court held that in the face of a "prima facie demonstration of prior use, the inventor then has the burden of proving that this use 'was not of a functionally operative device, or was substantially used for experimental or testing purposes.' "

This exception is to be guarded closely. "[T]he use of a single specimen, even in a factory and in the presence of a few employees, may be public." *A. Schrader's Sons, Inc.* v. *Wein Sales Corp.,* 9 F.2d 306, 308 (2d Cir. 1925) (L. Hand, J.); *see Consolidated Fruit Jar Co.* v. *Wright,* 94 U.S. 92 (1876). Likewise, a single instance of placing the invention on sale is sufficient to invalidate the patent. *Smith & Griggs Mfg. Co.* v. *Sprague,* 123 U.S. 249, 258 (1887); *Minnesota Mining & Mfg. Co.* v. *Kent Indus., Inc.,* 409 F.2d at 100.

The District Court found that "the product was prescribed by physicians, sold by Bergstein and used by patients to treat physical disorders," and that "[t]he record . . . is clear beyond any doubt that Bergstein's use was not experimental." This finding is supported fully by the record.[1]

[1] It, therefore, is unnecessary to decide if experimental use by a person other than the inventor or someone within the inventor's control, is an exception to the bar against prior use. *Compare Dunlop Co., Ltd.* v. *Kelsey-Hayes Co.,* 484 F.2d at 413-14 *with Magnetics, Inc.* v. *Arnold Engineering Co.,* 438 F.2d 72, 74 (7th Cir. 1971).

Since the record demonstrates that there was prior public use, and that the use was not privileged or "experimental," we agree with the conclusion of the District Court that the patent is invalid under 35 U.S.C. § 102(b).

II.

Although the District Judge correctly decided the issue of the invalidity of the patent, he erred in directing that the accumulated royalties held in escrow be paid over to the licensor, Moraine. This arises from a misinterpretation of the decisions of this court in *Troxel Manufacturing Co.* v. *Schwinn Bicycle Co.,* 465 F.2d 1253 (1972) (hereinafter referred to as Troxel I) and *Troxel Manufacturing Co.* v. *Schwinn Bicycle Co.,* 489 F.2d 968 (1973), *cert. denied,* 416 U.S. 939 (1974) (hereinafter referred to as Troxel II). The basic error of the District Court is reflected in this statement: "*Troxel* permits the licensor to keep the royalties when they have been paid during the course of litigation." 350 F.Supp. at 359.

Troxel did *not* involve an action by a licensee attacking the validity of a patent owned by the licensor. It was *not* the type of suit authorized by *Lear* v. *Adkins,* 395 U.S. 653 (1969).

The present suit *is* an action by a licensee, Atlas, attacking the validity of a patent owned by the licensor, Moraine. The instant case *is* the type of suit, authorized by *Lear* v. *Adkins.*

In *Lear* the Court adopted an earlier dissenting view of Mr. Justice Frankfurter that the doctrine of licensee estoppel should be given "a decent public burial." 395 U.S. at 667. (Citation omitted.) The right of Atlas to bring this action as licensee to litigate the validity of the patent therefore is unquestioned. In *Lear,* as in the present case, the issue of the obligation to pay royalties also arose. In *Lear* there is an even stronger case for the continued payment of royalties to the licensor since an express contractual pro-

vision in the license agreement required that royalties must be paid up until the time the "patent . . . is held invalid." *Id.* at 673. As in the present case, in *Lear* the licensee also derived some benefit from the pre-issue disclosure. The Court stated:

> "[I]t may be suggested that although Lear must be allowed to raise the question of patent validity in the present lawsuit, it must also be required to comply with its contract and continue to pay royalties until its claim is finally vindicated in the courts." *Id.* at 673.

The Court then focused on

> "[t]he decisive question is whether overriding federal policies would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging patent validity in the courts." *id.*

The Supreme Court concluded that "such a requirement would be inconsistent with the aims of federal patent policy," *Id.* After an exhaustive discussion of these policy reasons, *see id.* at 673-74, the Court expressly held "that Lear must be permitted to avoid the payment of all royalties accruing after Adkins' 1960 patent issued if Lear can prove invalidity." *Id.* at 674.

Our prior decisions are in harmony with these principles. In *Troxel I* we stated that a "licensee may at any time cease royalty payments, secure in the knowledge that the invalidity of the patent may be urged when the licensor sues for unpaid royalties." 465 F.2d at 1260. This court, speaking through Judge Kent, further interpreted the holding in *Lear* to mean:

> "that a licensee should not be required to pay royalties while challenging the validity of the patent [and] concluded that requiring such payment would undermine the federal policy favoring full and free use of ideas in the public domain." *Kewanee Oil Co.* v. *Bicron Corp.*, 478 F.2d 1074, 1085 (6th Cir. 1973), *rev'd on other grounds*, 416 U.S. 470 (1974).

It is urged that the foregoing analysis conflicts with our decisions in the two *Troxel* cases. To the contrary, those cases have an independent basis, recognized by *Lear*, and implement some of the underlying policies which require our decision in the present case. In the *Troxel* cases the licensee was doing nothing to contest the validity of the patent. The licensee continued to enjoy the fruits of the license. Only because of *Blonder-Tongue Laboratories, Inc.* v. *University of Ill. Foundation*, 402 U.S. 313 (1971), did the licensee become an incidental beneficiary to the invalidity established in the litigation initiated and prosecuted by another party in another circuit. *Lear* explicitly recognized the law of this Circuit that "[i]t is generally the rule that licensees may avoid further royalty payments, regardless of the provisions of their contract, once a third party proves that the patent is invalid. *See, e.g., Drackett Chemical Co.* v. *Chamberlain Co.*, 63 F.2d 853 (1933)," 395 U.S. at 667.

In *Troxel I* we stated that "the rationale of *Drackett* remains the law of this Circuit except insofar as it expresses the licensee estoppel doctrine." 465 F.2d at 1259. It is apparent that *Drackett's* facts limit its application to the instances where the invalidity of the patent is challenged and proved by a third party. Further, we made it clear in *Troxel I* that there were differences in the equities of the situation if either the licensee himself was attacking the validity, or the licensee was seeking the refund of royalties *actually paid* to the licensor. One of the primary goals in *Lear* was to "unmuzzle" licensees so that an early adjudication of invalidity could inure to the public interest. We rejected the contention that the licensee should recover the total royalties paid prior to the adjudication of in-

validity of the patent because this would give the licensee the legal equivalent of a "heads-I-win, tails-you-lose" advantage in a license agreement. Expeditious evaluation of the patent would be defeated:

> "If the licensee could recover royalties paid (subject to any statute of limitations) on the basis of an adjudication of invalidity accomplished by another litigant, without incurring the expense or trouble of litigation, there would be less inducement for him to challenge the patent and thus remove an invalid patent from the competitive scene. He would be more likely to wait for somebody else to battle the issue because he would have nothing to lose by the delay.
>
> "Rather than stimulating early litigation to test patent validity, such an interpretation of *Lear* would make it advantageous for a licensee to postpone litigation, enjoy the fruits of his licensing agreement, and sue for repayment of royalties near the end of the term of the patent. When a licensed patent is about to expire and the threat of injunction no longer exists, a licensee would have little to lose in bringing an action to recover all the money he has paid in royalties on the ground of the invalidity of the patent. The licensee would have a chance to regain all the royalties paid while never having been subjected to the risk of an injunction. Such an interpretation of *Lear* would defeat one of the expressed purposes of the court in announcing that decision." 465 F.2d at 1257.

It is apparent that these equitable considerations commend an opposite result in the present case. The freedom from royalty payments, at as early a date as possible, is a strong "inducement . . . to challenge the patent and thus remove an invalid patent from the competitive scene." *Id.* Moreover, the licensee would not be "likely to wait for somebody else to battle the issue," *id.*, if he were to lose his

royalties while sitting on his rights in the hope for a valiant third party to pull the chestnuts out of the fire. The cases in the other Circuits which have reached this issue are in agreement with our interpretation. The Second Circuit has stated:

> "What *Lear* precisely held was that the courts may not enforce a royalty agreement with respect to an invention embodied in an American patent while the licensee was contesting its validity and could recover only when, as and if validity was established." *Painton & Co., Ltd.*, v. *Bourns, Inc.*, 442 F.2d 216, 226 (1971).

The Supreme Court has quoted with approval the statement in *Painton, id.*, that if an invalid patent issues: "many will prefer to pay a modest royalty than to contest it, even though *Lear allows them to accept a license and pursue the contest without paying royalties while the fight goes on.*" *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470, 488 (1974). (Emphasis added.)[2]

The payment of royalties in escrow does not change the result in this case. While an escrow is a commendable procedure to preserve the status quo during the course of litigation, the funds belong to neither party until the validity of the patent is determined.

The termination of the obligation to pay royalties in the *Troxel* cases is in part tied to the fact that "Troxel did not cease royalty payments prior to the Ninth Circuit's holding of invalidity," *Troxel II*, 489 F.2d at 973. The claim that a licensor could be compelled "*to repay all royalties* received

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[2] *See* also *Congoleum Indus., Inc.* v. *Armstrong Cork Co.*, 366 F.Supp. 220, 233 (E.D. Pa. 1973); *Horwitt* v. *Movado Watch Agency, Inc.*, 364 F.Supp. 687, 689 (S.D.N.Y. 1973); *see generally Ransburg Electro-Coating Corp.* v. *Spiller & Spiller, Inc.*, 489 F.2d 974, 976-77 (7th Cir. 1973); *but see Kraly* v. *National Distillers and Chem. Corp.*, 502 F.2d 1366 (7th Cir. 1974).

from its licensees," *Troxel I*, 465 F.2d at 1259 (emphasis added), was soundly rejected.[3]

We reverse that part of the judgment of the District Court ordering payment to Moraine of escrowed royalties.

III.

The District Court awarded Moraine $139,495.40 in summary judgment for costs and expenses incurred in prosecuting the patent, and "in defending the patent against alleged infringers." 350 F.Supp. at 359. Costs and attorneys fees involved in the present action were not included. The theory on which this award was made was that Atlas had been guilty of unconscionable conduct when it did not disclose what it knew of the prior use during the prosecution of the patent.

It is unnecessary for us to inquire as to either the substance of these allegations, or whether if correct they could form the basis for relief. The award must fail because this issue was not properly before the court by appropriate pleadings.

Rule 56, Fed. R. Civ. P., permits summary judgment for a "party seeking to recover upon a claim, counterclaim or cross-claim." A defending party may also move for summary judgment, but only as to a claim, counterclaim or cross-claim that has been asserted against him. Rule 56(b). In order to receive affirmative relief the party must become a claimant and assert the proper pleading. Rule 12(b)

[3] *Troxel I* and *Troxel II* announce and apply precisely the same rule with respect to the cut off date for liability for royalties where the licensee did not sue to challenge the validity but continued to pay royalties until invalidity was declared in other litigation challenging the validity of the patent. In that situation liability of the licensee for royalties ceases on the date of eviction of the patent, that is, the date as of which the patent is determined to be invalid. This is the holding in both cases. *Troxel I*, 465 F.2d at 1259-60; *Troxell II*, 489 F.2d at 973.

relaxes the formal requirements of pleading and allows certain defenses to be made by motions at the option of the pleader. However, none of these exceptions, nor those embodied in other rules, encompass affirmative relief of the type awarded in the present action. In the present case Moraine did not file a counterclaim, *see* Fed. R. Civ. P. 13. Atlas, therefore, was deprived of notice as to the nature of the claim or the relief that might be due. Fed. R. Civ. P. 8.

Professor Moore states the fundamental rule as follows:

> "[T]he function of pleadings under the Federal Rules is to give *fair notice* of the claim asserted so as to enable the adverse party to answer and prepare for trial, to allow for the application of the doctrine of res judicata, and to show the type of case brought, . . . so that it may be assigned to the proper form of trial. 2A Moore's Federal Practice ¶ 8.13 at 1695. (Footnote omitted.)

It is elementary that proper pleadings are a prerequisite to recovery. *New & Used Auto Sales, Inc.* v. *Hansen*, 245 F.2d 951 (9th Cir. 1957); *See Armstrong Cork Co.* v. *Lyons*, 366 F.2d 206 (8th Cir. 1966).

Since these damages were never pleaded they cannot be recovered.

Moraine relies upon the decision of this court announced by Judge McAllister, in *Jack Mann Chevrolet Co.* v. *Associates Inv. Co.*, 125 F.2d 778 (1942). In the absence of adequate pleadings we cannot reach this issue.

We reverse that part of the judgment of the District Court which awards $139,495.40 to Moraine for costs and expenses.

IV.

Atlas contended that the Moraine patent was procured fraudulently, and that Moraine, therefore, was liable for

attorneys fees, 35 U.S.C. § 285, see *Deyerle* v. *Wright Mfg. Co.*, 496 F.2d 45 (6th Cir. 1974), or a refund of paid-in royalties, *see Troxel I*, 465 F.2d at 1259 n. 5. Although a patent applicant is held to "the highest degree of candor and good faith," *Kingsland* v. *Dorsey*, 338 U.S. 318, 319 (1949), when dealing with the Patent Office, we are in agreement with the action of the District Court in ruling against Atlas on this issue.

The judgment of the District Court is affirmed as to the invalidity of the patent and reversed on the issues of the escrowed royalties and the pre-litigation costs and expenses.

Costs are taxed against Moraine Products.